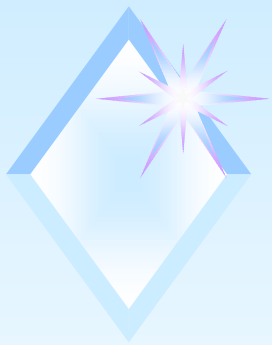




Performance-Based Standards in Contracting

A presentation by
Stephen B. Gordon, Ph.D., CPPO
Purchasing Agent
Metropolitan Government of Nashville and Davidson County
to the
Arkansas Chapter of NIGP
March 26, 2004



Goals

To enable you and your agency to:

- ✦ Comply with section 19-11-1010 of the Arkansas code of laws, and the regulations thereto (state agencies)
- ✦ Implement and use **performance-based** contracting as advantageously as possible (all).



Areas to be Addressed

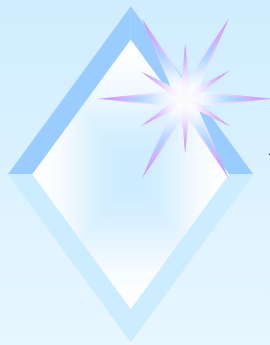
- ⊕ Elements of performance based contracting
- ⊕ Reasons to contract on a performance basis
- ⊕ Preparing to contract
- ⊕ Necessary action steps
- ⊕ Common obstacles and how to overcome them
- ⊕ Building PBC into the work plan and budget
- ⊕ Resources



Different Words, Same Meaning



- ✦ Productivity Based Contracting
- ✦ Performance Based Contracting
- ✦ Results Based Contracting
- ✦ Outcome Based Contracting



Definition of “Performance Based Contracting” (“PBC”)

“Performance Based Contracting entails structuring all aspects of an acquisition around the *purpose* of the work to be performed as opposed to *how* the work is to be performed.

It emphasizes quantifiable, measurable performance requirements and quality standards in developing statements of work, selecting contractors, determining contract type, structuring incentives, and performing contract administration, including surveillance.”

NASA



Why Should You Consider Performance-Based Contracting?



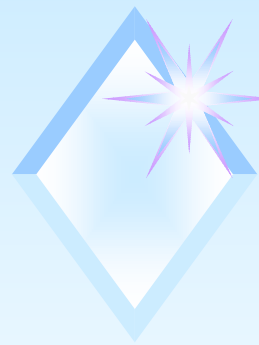
- ✦ Legal compliance (state agencies)
- ✦ Agency's or government's best interest
- ✦ Assured results, or a higher level of assured results
- ✦ Recouped “lost” funds, lower ongoing expenses, or net revenue
- ✦ Simplified and more economical procurement and contract administration



PBC Promotes Best Value by:

- ✦ **Establishing the Total Cost or Worth of a Contract with a Particular Offeror.**
- ✦ **Allowing and Encouraging Maximum Competition based on Cost and Quality.**
- ✦ **Simplifying Contract Administration .**

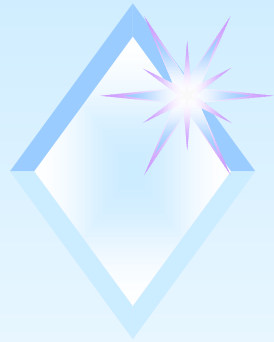




PBC Assures Results, and Allows and Encourages Cost and Quality Improvements through:

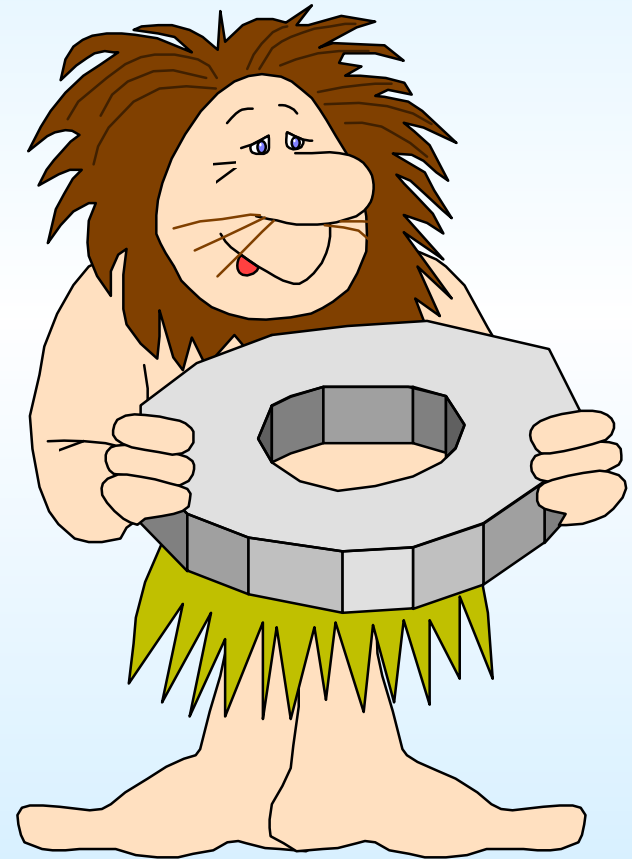


- ✦ Measurable Outcome Requirements
- ✦ Contractual Commitments to Achieve Results
- ✦ Accountability and Rewards for Accomplishments



Problems with Traditional (Level of Effort) Contracting

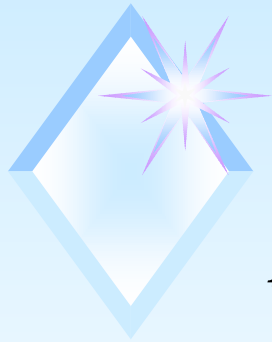
- ✦ Vague, incomplete, and outdated plans, specs, and statements of work
- ✦ Few or no quantifiable performance standards
- ✦ Inadequate cost measurement and control
- ✦ Costly (or no) contract administration





Performance Based Contracting is More “Business Like”

- ✦ To the extent practical, statements of work specify required outputs and/or outcomes instead of inputs, activities, processes, and “level of effort.”
- ✦ Also to the extent practical, resulting contracts reflect substantial contractor input as to how the work is to be performed.
- ✦ Government’s management role shifts from telling the contractor when and how to do its work to measuring the impact of work performed.



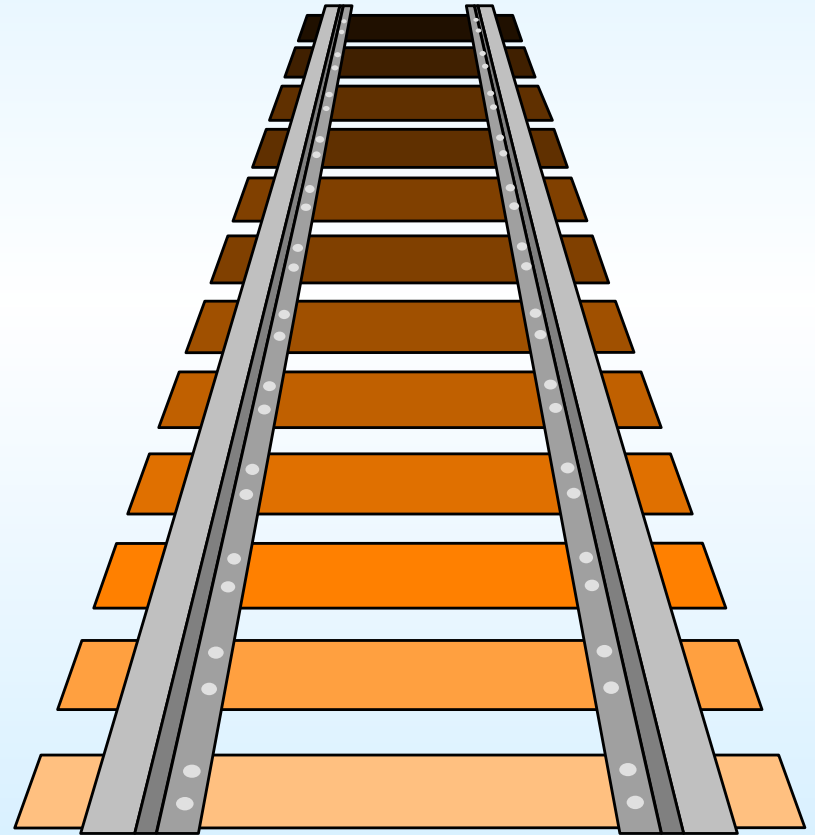
Contractors Are More Accountable

- ✦ Pay is tied to fulfilling performance requirements and complying with quality standards.
- ✦ Performance requirements and quality standards are quantifiable and measurable.



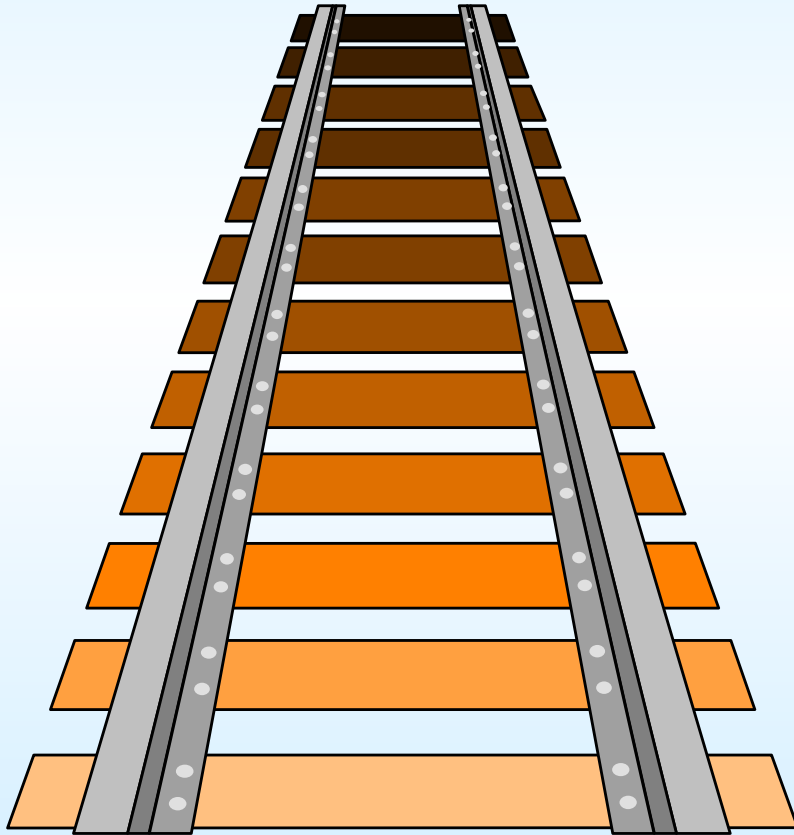
Internal Barriers to Using Performance Based Contracting

- ✦ Focus on **hard dollars** and/or “**control**”
- ✦ **Cycle time** and **staff time** required on the “front end”
- ✦ No **authority** to use RFPs
- ✦ Difficulty of **quantifying outcomes**





External Barriers

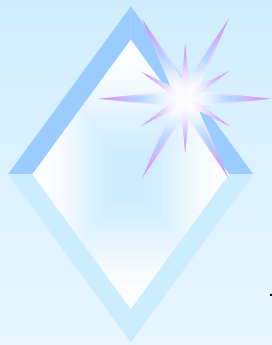


- ✦ There are few or no **potential providers** of the required service or good.
- ✦ The anticipated **risk or effort for vendors** exceeds the anticipated return
- ✦ The **ability of the particular industry to respond effectively** is limited.

Preparing to Contract on a Performance Basis

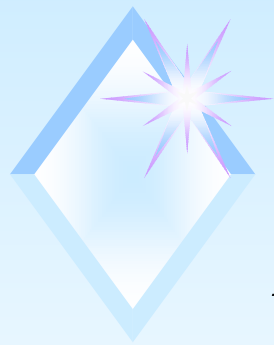
- ✦ Developing the contract
- ✦ Selecting the services





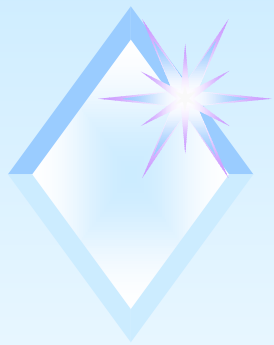
Contract Development for PBCs

- ⊕ **Contractor selection** is typically accomplished through a Competitive Sealed Proposals (RFP) process.
- ⊕ **Compensation** can be on:
 - ⊕ firm fixed price basis (with or without incentives) or
 - ⊕ shared savings basis (depending on the service involved and the particular circumstances).
- ⊕ **Incentive provisions** are based on:
 - ⊕ measurement against predetermined performance standards
 - ⊕ surveillance plans, not detailed inspection (typically).



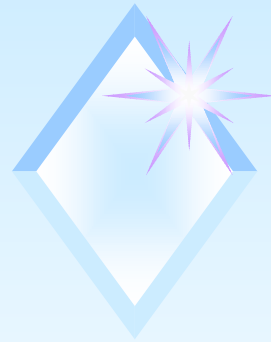
Using an RFP to Establish a Performance Based Contract

- ✦ “Best value” is the basis of award.
- ✦ Competing offerors propose solutions to meet the performance requirements.
- ✦ Net *committed* economic outcome is a significant, but not the only evaluation factor.
- ✦ Other considerations also are important.



Typical Evaluation Factors

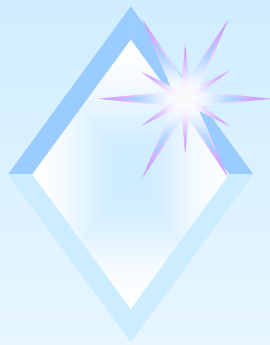
- ✦ ***Cost*** to execute the proposed Business Plan
- ✦ Quality of the ***Business Plan*** (including committed technical performance and the risk to the government posed by proposed approach)
- ✦ ***Capacity of the Firm/Team*** to implement the proposed Business Plan
- ✦ ***Customer Assessments of Past Performance***
- ✦ Others, such as Committed Level of Small Business Participation



Performance Contracting Concepts/Lingo



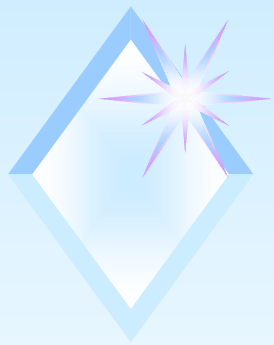
- ⊕ Outcomes
- ⊕ Outputs
- ⊕ Inputs
- ⊕ Activities
- ⊕ Levels of Outcomes
- ⊕ Outcome Indicators
- ⊕ Outcome Targets



Outcome - a contemplated, beneficial result of a contract

Outcomes fall into two broad categories:

- ⊕ “Technical” Outcomes (e.g., the removal of fallen trees from park land following a natural disaster)
- ⊕ “Economic” Outcomes (e.g., a fee paid **to** the government **by** the contractor for the right to take valuable trees for its own use)



Outputs

- ⊕ Definition: products of a program's activities
- ⊕ AKA “units of service”
- ⊕ *Should* produce outcomes (Our role?)
- ⊕ Examples:
 - ⊕ Number of trash cans emptied
 - ⊕ Number of offices vacuumed
 - ⊕ For fire and emergency goods and services?



Inputs

- ✦ The resources that a contractor uses to achieve outcome targets
- ✦ Examples include proposed staffing, subcontracting, facilities, equipment, financing, supplies, etc.
- ✦ Our role and responsibility? When?





Activities



- ✦ **Definition:** What a contractor does with its inputs, to produce outputs and achieve outcomes
- ✦ **Examples:**
 - ✦ Emptying trash cans
 - ✦ Vacuuming floors
 - ✦ Dusting furniture
- ✦ **Questions:** Where will we evaluate the potential impact of proposed activities? The actual impact?



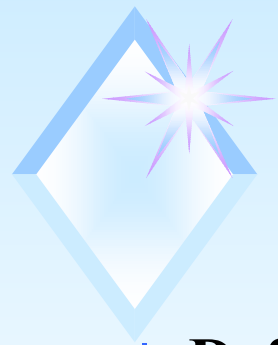
Levels of Outcomes

- ✦ **Intermediate vs. End**

- ✦ **Example of multiple levels:**

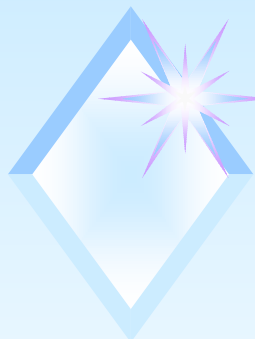
“A youth in a mentoring program who receives one-to-one encouragement to improve academic performance may attend school more regularly, which can lead to better grades, which can lead to graduating.” [Measuring Program Outcomes: A Practical Approach (United Way, 1996)]

What are some examples of services that a state department of transportation provides/buys for which it is possible and practical to include end outcomes in a contract?



Outcome Indicators

- ✦ **Definition:** the specific items of data that are tracked into order to measure a contractor's success on outcomes.
- ✦ **Function:** Describe observable, measurable characteristics or changes that represent achievement of an outcome.
- ✦ **Forms They Can Take:** Several, depending on the required performance outcome, including, for example:
 - ✦ Whether milestones were met
 - ✦ Number and/or percentage of successes
 - ✦ Costs reduced or savings generated
- ✦ Some outcomes may require > one indicator
- ✦ Examples for the state highway patrol department?
 - ✦ Goods?
 - ✦ Services?



Example of Outcome with Outcome Indicators

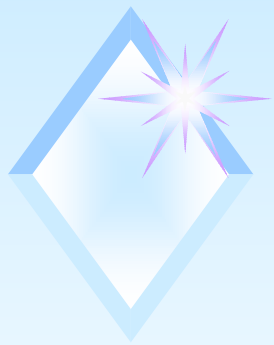
From: Measuring Program Outcomes: A Practical Approach (United Way of America, 1996), Exhibit 3-B, Example Outcomes and Outcome Indicators for Various Programs.

⊕ **Program:** Smoking Cessation

⊕ **Outcome:** Participants stop smoking.

⊕ **Outcome Indicators:**

- ⊕ No. and % of participants who report that they have quit smoking by end of program.
- ⊕ No. and % of participants who have not relapsed 6 months after program completion.



Outcome Targets

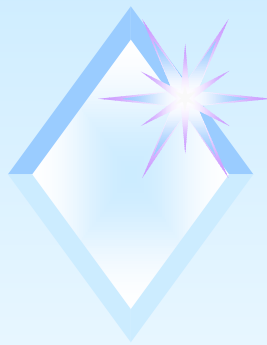
- ⊕ **Definition:** numerical objectives for a contractor's achievement on outcomes
- ⊕ Synonymous with “**performance standards**”
- ⊕ Should be “**S.M.A.R.T.**”
- ⊕ Can be specified in the solicitation *or* arrived at through proposal and agreement
- ⊕ Purpose of **benchmarks**



Activity No. 1

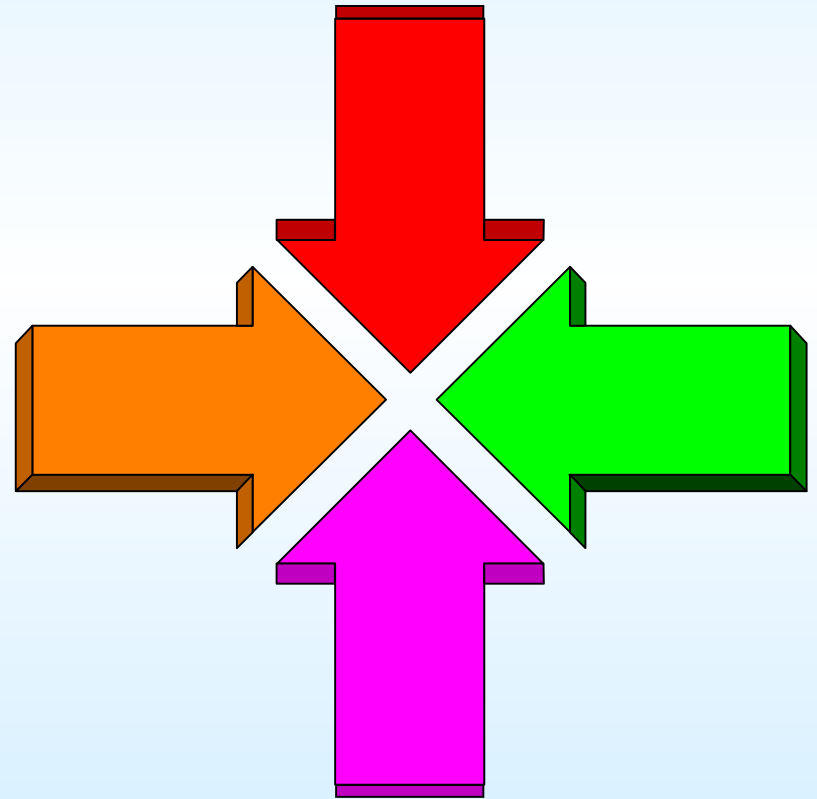
Working in small groups, develop a set of performance outcomes, outcome indicators, and outcome targets for the assigned service below:

- ✦ Landscape maintenance for a state park
- ✦ Pest control services for the state capitol
- ✦ Management and operation of the state penitentiary
- ✦ Purchasing services (for the direct service providers) in your agency or jurisdiction



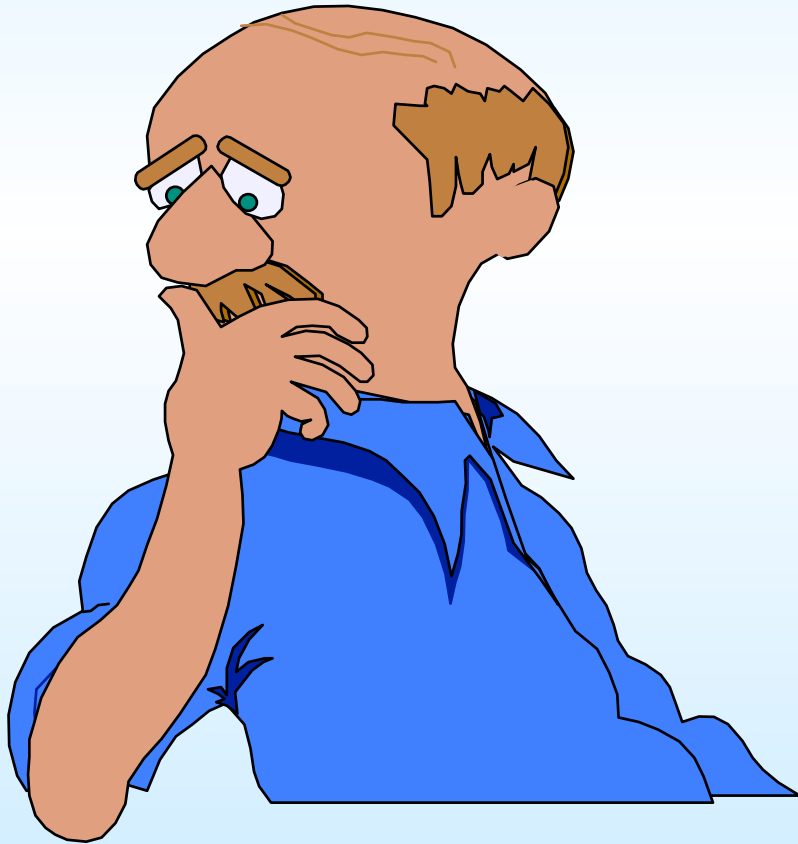
Forms that Performance Contracts Can Take

- ⊕ Firm Fixed Fee or Price with one or multiple payments
- ⊕ Performance Incentive
- ⊕ Hybrids





Use “Fixed Fee” and “Fixed Price” PBCs When:

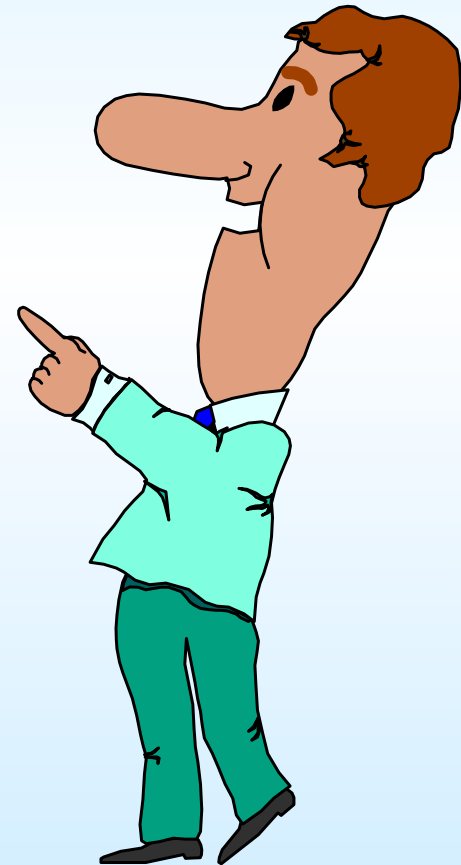


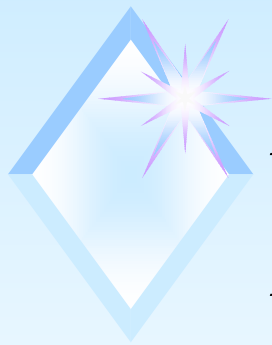
- ✦ A service can be objectively defined.
- ✦ Risk of performance is manageable.
- ✦ Service is routine and frequently acquired.
- ✦ Only a minimum acceptable level of performance is required.



Examples of Actual or Potential PBKs - Firm Fixed Fee or Price

- ✦ Consulting Engagements with Required Deliverables
- ✦ Construction
- ✦ Highway Management
- ✦ Job Placement
- ✦ Technology Solutions

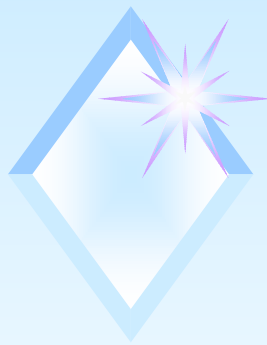




Performance Incentive (PI)

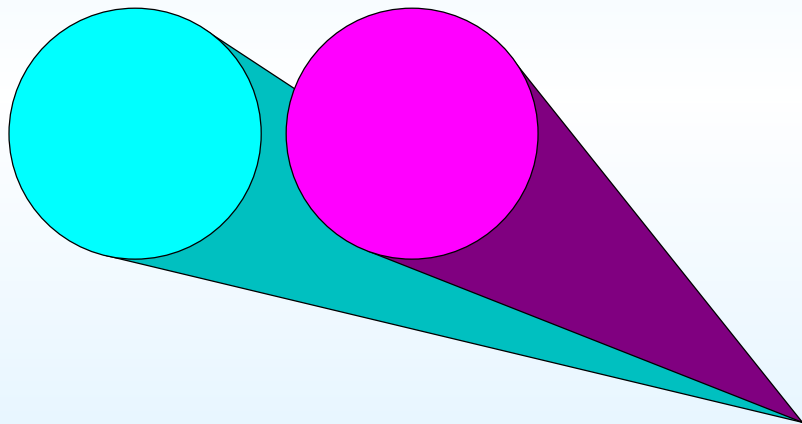
PBCs

Definition: “In a performance incentive contract, the parties establish at the outset a pricing basis for the contract, performance goals, and a formula which varies the profit or the fee if the specified performance goals are exceeded or not met.” MCL R4.12.140.07



Performance Incentive (PI)

PBC Variations



- ✦ “Shared Savings/Revenue” (with or without minimum commitments)
- ✦ “Firm Fixed Price or Fee” with bonuses and/or liquidated damages



Bonuses and Damages

- ⊕ Bonus provisions can be included to reward contractors for achieving more than the required minimum.
- ⊕ Likewise, liquidated damages provisions can be included to penalize contractors for producing at a below minimum level.
- ⊕ Specified “soft” dollar values are linked to the units of measure for performance (e.g., \$1,000 per day).



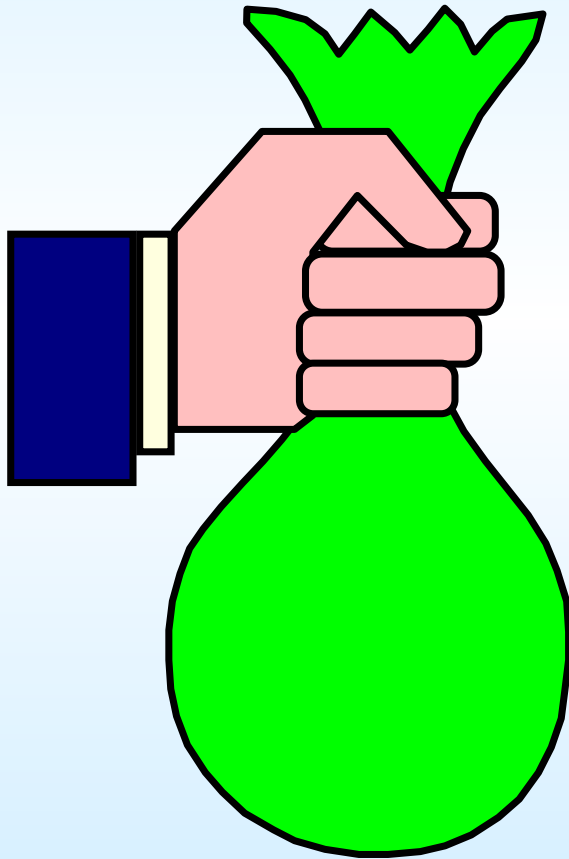
Distinguishing the Two Types



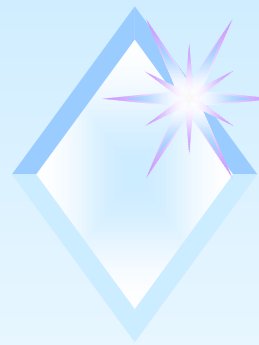
- ✦ Shared Savings or Revenue Generating K's typically link rewards to “hard” dollar savings or revenue generated.
- ✦ FFP/F PBKs with bonuses and penalties typically link rewards and sanctions to pre-agreed “soft” dollars.



In Any Performance Based Contract, Compensation is Contingent



- ✦ Contractor gets paid only after its solution has been successfully implemented.
- ✦ There is no fixed rate or fee for *outputs* (e.g., hours devoted to software installation, training, etc.)



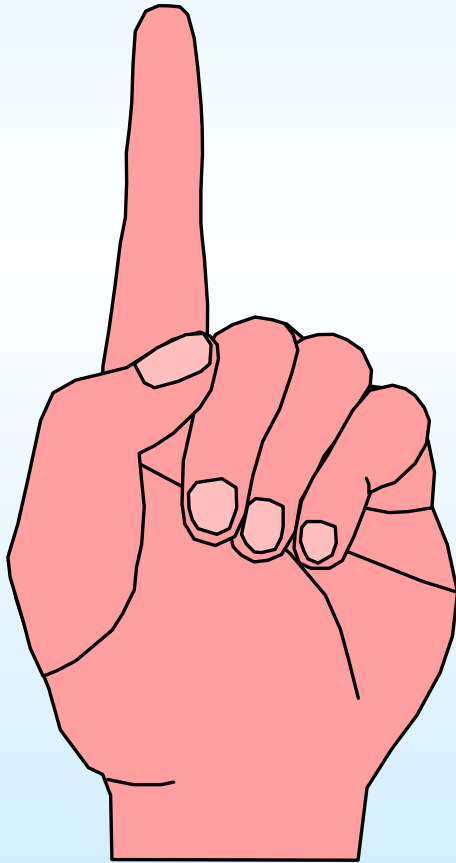
In a Pure “Shared Savings” or “Revenue Generating” “PIK”, Compensation is Completely Contingent

- ✦ Contractor derives its “pay” from the economic *outcomes* it produces (e.g., its “share” of the cost reduction resulting from a more skilled workforce).
- ✦ The money used to pay the contractor was **not budgeted** for the PBC.
- ✦ Contractor is completely “at risk.”





Typical Applications of “Shared Savings or Revenue” Contracting by State and Local Governments



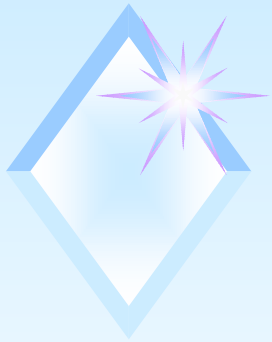
- ✦ Bad debt collection
- ✦ Building and facility energy management
- ✦ Utility Audits
- ✦ Concessions



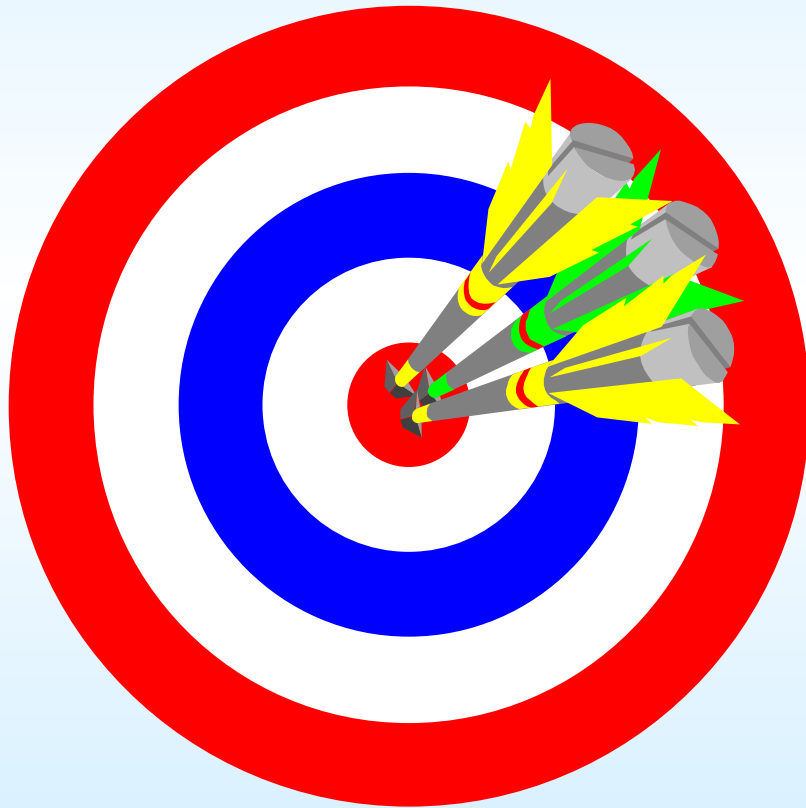
Selecting Services for PBC

- ⊕ **Simpler the better**
- ⊕ **High success probability**
- ⊕ **Has been done elsewhere**
- ⊕ **Capable and interested contractors**
- ⊕ **Interested and capable departments**
- ⊕ **Supportive management**

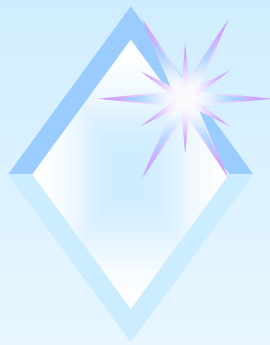
*Not
rocket
science*



Good Prospects



- ✦ Services which carry the name of one solution (brush “chipper” service as opposed to brush “removal” service)
- ✦ Time and materials contracts
- ✦ Known to be uncontrollable or have “cost creep”
- ✦ Quick results needed



Examples of U.S. Navy's “Regular” PBCs

- ✦ Bus Services
- ✦ Central Heating Plant and Distribution Systems Operation, Repair and Maintenance
- ✦ Custodial Services
- ✦ Guard Services
- ✦ Operation of Telephone/Communication System



Examples of Metro Nashville's “Regular” PBCs

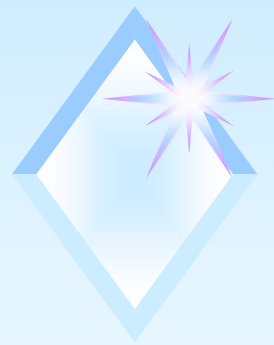
- ✦ Operation of Correctional Facility
- ✦ Mainframe Migration
- ✦ Disparity Study
- ✦ Procurement Card Services and Travel Management Services
- ✦ Building Monitoring and Alarm



Examples of Metro Nashville's Shared Savings Contracts

- ✦ Utility Audits
- ✦ Building Energy Management
- ✦ Unbilled and Misbilled Water
- ✦ Medical Billing and Collection

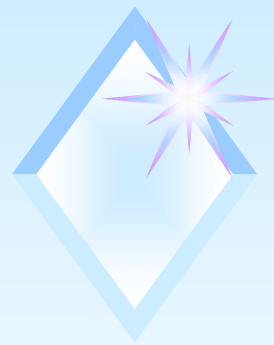




Examples of Metro's Revenue Generating PIKs



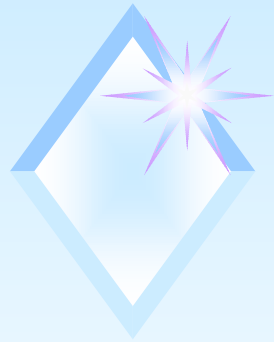
- ✦ Indoor Advertising
- ✦ Telecomm and Data Services for Exhibitors
- ✦ Operation of A/V Center for Exhibitors
- ✦ ATM (at Fairgrounds)
- ✦ Coin Operated Copiers
- ✦ Inmate Telephones
- ✦ Golf Carts



Performance-Based Metro Contracts for Infrastructure

- ✦ Design-Build
Construction of
Animal Care and
Control Facility
- ✦ Design-Build Reno-
vation of Stahlman
Building Elevators
- ✦ Fast-Track (Re-)
Construction of
McCabe Clubhouse

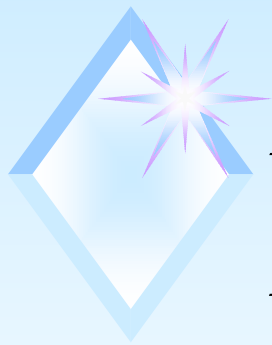




Other Performance-Based Metro Contracts for Infrastructure



- ✦ Cleaning of Water Lines for MWS
- ✦ Leak Abatement for Water (Main) Lines
- ✦ Reduction of Inflow and Infiltration into Sewer Lines



Necessary Action Steps for Individual Services

1. Define outcomes
2. Identify contractors
3. Develop the statement of work (SOW)
4. Determine contract type



Necessary Action Steps (cont.)

5. Estimate cost/budget impact
6. Establish a monitoring plan
7. Solicit proposals
8. Evaluate proposals



Necessary Action Steps

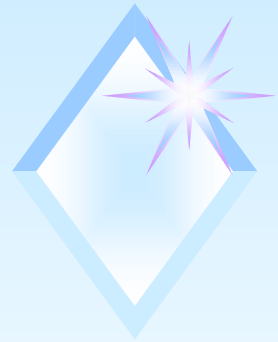
9. Launch the contract
10. Evaluate performance



1. DEFINE OUTCOMES

- ⊕ Intermediate and end
- ⊕ Indicators
- ⊕ Targets
- ⊕ Sources of knowledge

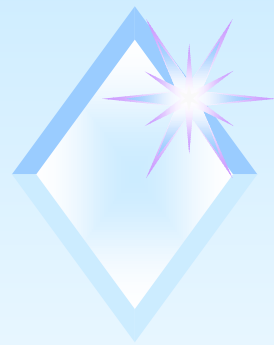




2. IDENTIFY CONTRACTORS

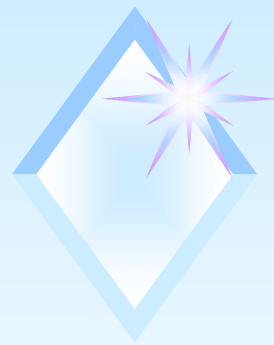


- ✦ All potential providers
- ✦ All available sources and avenues



3. DEVELOP THE STATEMENT OF WORK (SOW)

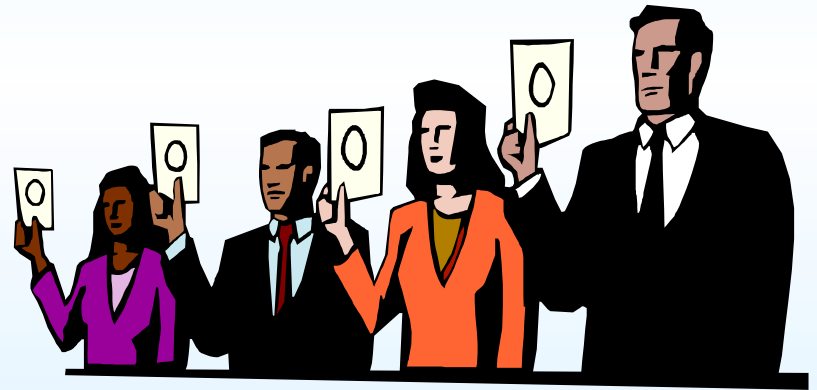
- ✦ Introduction/Overview
- ✦ Required/Desired Performance Outcomes
- ✦ Constraints on the Contractor
- ✦ Contractor Personnel Requirements
- ✦ Contractor Responsibilities
- ✦ Government's Responsibilities
- ✦ Terms and Conditions of Contract
- ✦ Instructions, including Format of Proposal and Evaluation of Proposals



4. *DETERMINE CONTRACT TYPE*

Consider whether the contract objective is:

- ✦ “Best” minimum result
- ✦ “Better than best” minimum result
- ✦ Reduced cost
- ✦ Generation of revenue





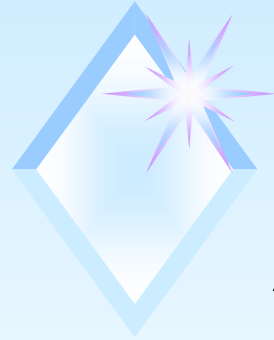
Also consider:

- ⊕ Availability of budgeted funds
- ⊕ Authority and willingness to pay bonuses
- ⊕ Feasibility of sharing reduced costs
- ⊕ Feasibility of sharing generated revenue

5. *ESTIMATE THE COST/BUDGET IMPACT*

- ⊕ Unless the contractor “front-ends” the cost, there has to be money in the budget
- ⊕ An estimate allows you to evaluate the reasonableness of proposed fees/costs.





6. ESTABLISH A MONITORING PLAN



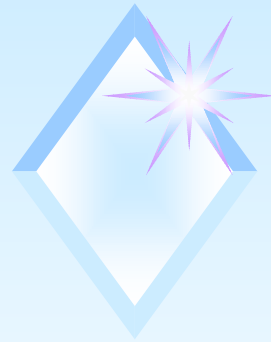
- ✦ Ideally, before you solicit proposals
- ✦ At least, before the delivery of the service begins



Monitoring Plan Elements

- ⊕ Who
- ⊕ How
- ⊕ Outcomes
- ⊕ Responsibilities
- ⊕ Constraints





Monitoring Strategies may include:

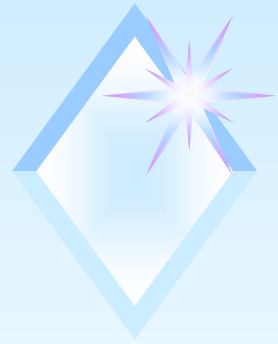


- ⊕ Logging complaints
- ⊕ Intensive staff oversight
- ⊕ Reviews of reports and other submittals
- ⊕ Financial audits



7. *SOLICIT PROPOSALS*

- ⊕ CSP method provides for best value
- ⊕ CSP method allows discussions
- ⊕ Multi-step bid is an alternative
- ⊕ Only use a particular method if authorized



8. *EVALUATE PROPOSALS*

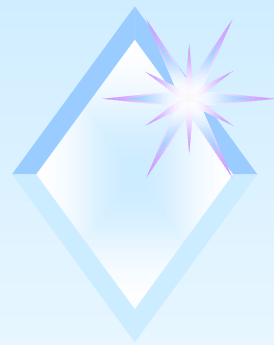
- ✦ Evaluation panel
- ✦ Evaluation factors
- ✦ Evaluation basics





Proposal Evaluation Basics

- ✦ Only the factors in the RFP
- ✦ Documentation of weights
- ✦ Affirmation of no conflict of interest
- ✦ Agreement not to disclose
- ✦ Independent, then consensus score
- ✦ Reference checks
- ✦ Clarification of proposals



Establishing the Baseline for Cost Savings

- ✦ Requires an accurate calculation of both the total (current) cost of the service and the avoidable cost portion of that total cost.
- ✦ Must consider all relevant ownership costs, including (adequate) contract administration.

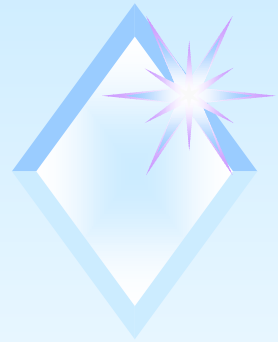




Activity No. 2

Working in the same group, rough out the following portions of a scope of work for an RFP to outsource your entity's procurement program on a performance basis:

- ✦ **Required/Desired Performance Outcomes (done)**
- ✦ **Constraints on the Contractor**
- ✦ **Contractor Personnel Requirements**
- ✦ **Contractor Responsibilities**
- ✦ **Government's Responsibilities**



9. *LAUNCH THE CONTRACT*



- ✦ Start-up conference
- ✦ Partnering



Start-Up Conference

- ⊕ Goal(s) for the service
- ⊕ Measurable outcomes
- ⊕ Monitoring plan
- ⊕ Payment plan
- ⊕ How corrective action will be taken
- ⊕ How superior performance will be rewarded
- ⊕ How issues will be resolved



Partnering

- ✦ Covenant to work together
- ✦ Win/Win not Win/Lose
- ✦ Agreement on mutual goals and objectives
- ✦ Agreement on strategies
- ✦ Open, frank, and regular communication
- ✦ Problems resolved promptly and at the lowest possible level

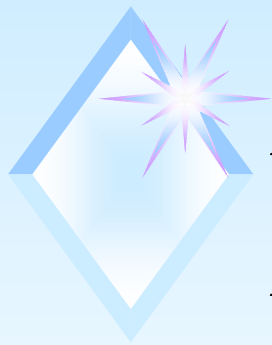




10. EVALUATE PERFORMANCE



- ✦ Measure performance accurately and fairly
- ✦ Implement the monitoring plan
- ✦ Learn and apply

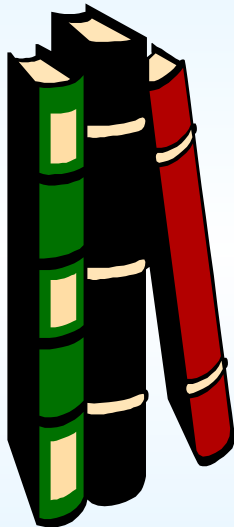


Building PBC into the Work Plan and Budget

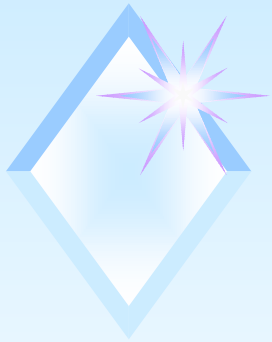
- ✦ PBC's place in the “bigger picture”
- ✦ A tactic, a strategy, a how
- ✦ Some contracts will require advance budgeting
- ✦ PBC should reduce total costs for many services



Resources



- ⊕ ICMA
- ⊕ GFOA
- ⊕ NIGP
- ⊕ Other



Questions(Now or Later)?



If you have a question
later, contact me at:

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